Capacity for change in the financial sector

AFM and DNB are working with the sector on achieving change

Joint study by the AFM and DNB

DeNederlandscheBank
EUROSYSTEEM

AFM
Autoriteit Financiële Markten

Part 1: Capacity for change in the financial sector

The financial sector is in the process of making major changes

These changes are necessary to bring about a stable, financially sound sector that exercises due care when providing financial services to customers. As these changes are related to the missions of both the Netherlands Authority for the Financial Markets (AFM) and De Nederlandsche Bank (DNB), we decided to conduct a joint study into the sector's capacity to implement major changes. This report presents the common themes identified in our research and explains how we intend to follow up on this topic in future.

What is capacity for change?

An organisation's capacity for change is the extent to which groups of people within that organisation are willing and able to effectively implement ambitions and objectives and ensure they succeed. It also includes the ability to adjust the process of change if the approach does not seem to be working or if there is a drastic change in circumstances. Are the drawn-up plans actually put to practice? Capacity for change is always linked to a specific change process. One department's successes cannot simply be copied to other parts of the organisation. The difficulties faced by a corporate banking department are different from those facing a compliance department. By studying different change processes at each organisation, however, we were able to identify certain patterns in factors promoting or impeding change that appear in more than one part of the organisation. Our research method is explained in part 2 of this report.

What role do the supervisory authorities play in enhancing capacity for change in the financial sector?

In our capacity as financial supervisory authorities, we focus on the most important risks. We believe that the biggest risks at the moment lie in ineffective changes being made and the financial sector failing to respond swiftly enough to external developments. In keeping with the increasingly forward-looking role of supervision, we decided to study the financial sector's capacity for change.

Time for the next step

The sector introduced measures in many areas in recent years. They include adjustments to strategy and core values, as well as resolution plans and specific matters such as mortgage interest policy and the settlement of claims. These are far-reaching measures that benefit consumers, but they are primarily instrumental adjustments to systems, processes and procedures. The next steps on the road to creating a healthy, sound and ethical financial sector that focuses on the interests of customers require that organisations make further changes to their business models, that entire organisations are committed to change, and that the business culture is changed effectively.
While every institution has its own frame of reference, culture and ambitions, we noted a number of similarities in the course of our study.
The economic climate still poses a threat to the soundness of financial enterprises. Further major changes will be required to enable a permanent focus on the interests of customers and ensure compliance with all legal and regulatory requirements. The organisations that took part in

this study partially work with outdated ICT systems with limited functionality, and they need to reduce costs and carry out fundamental reorganisations, which may lead to job losses. In addition, the creation of the European banking union means banks will have to ensure they comply with new rules. This ambitious agenda for change needs to be carried out by a sector that continues to struggle with its image. Public trust in financial enterprises has been dented by the crisis, and the position of the financial sector in society is still difficult. Consequently, the public, politicians and supervisory authorities are continuing to demand change. This has led to additional legislation and regulations, among other things, putting organisations under additional pressure.
In short, the financial sector is experiencing difficult times and it is having to deal with fundamental issues. Is the financial sector for example acting in the interests of society or in its own interests? How can the sector restore public trust? And how will the sector ensure that long-term interests come before short-term incentives? The massive impact of these issues became clear in the course of the many interviews that the AFM and DNB held with staff of banks and insurance companies. We can see that, despite the difficulties, bank and insurance staff are proud of their work and are keen to win back trust. They do, however, get frustrated in case of insufficient progress or a lack of public appreciation.

How did we approach our study into capacity for change?

In 2013 we investigated capacity for change at several banks and insurance companies, looking at aspects such as comprehensive cultural change programmes, or the introduction of new operating procedures in specific departments.
Our aim was to bring into focus recurring success factors and impediments. Given this, our study was not limited to just one particular change. Rather than looking at specific incidents, we were interested in identifying patterns. Working in close consultation with the organisations, we selected a number of specific change processes as the subject of our study.

What have we found?

The common themes of our findings are described below. Not all of our findings apply to every one of the organisations that took part in the study, let alone all the organisations operating in the financial sector. Our findings give an impression of what we frequently observed and provide pointers for a follow-up.

Genuine willingness to change

Employees working at all levels of the financial sector are highly motivated to bring about change successfully.

A common theme that emerged is that staffs at all levels are very willing to change, which is particularly striking given the difficult economic context. We spoke to people who felt strongly committed to the need for change (e.g. the simplification of products and services). Most people we interviewed were positive about the changes that have been made, particularly when those changes required them to use their professional expertise. This sense of positivity is reinforced when changes start to bear fruit. We heard people say that they were getting positive feedback from customers again, or that they had something positive to say about work again at parties. By supporting change and inspiring their staff, the people at the top of the organisation demonstrate a willingness to change.

Widely shared sense of urgency

The leading figures at the financial institutions have a widely shared sense of the urgent need to make changes now (and changes are actually being made).

Organisations are aware of the need for change, partly because they need to ensure their own survival, and partly because some matters simply require improvement. Moreover, the organisations that took part in this study are aware of the need to become more innovative so that they are less likely to be caught out unawares and are better able to respond to future changes. Management boards and other senior managers are also expressing this sense of urgency and encouraging their staff to feel it too. As a result, management can put its energy into introducing changes, and staff are better able to accept the painful or difficult aspects of the change process as well (e.g. job losses).

Priorities not sufficiently clear

The priorities set in the numerous challenges currently facing financial institutions are not sufficiently clear.

Sometimes not enough clear cut choices are made, as a result of which employees are assigned more and more work, often requiring them to work extra time. In addition, staff members generally found that they are unable to get to the crux of the change due to regulatory burdens and the systems they currently have to work with. Even if clear choices are made, management often does not use them as guidance when managing staff and they are not sufficiently checked against reality reality, e.g. What does this mean for people on the shop floor? As a result, people are given the freedom to stick to familiar methods, and no real change is made.

Failure to set sufficiently clear priorities leads to the following risks:

- Employees do not feel that the changes form a coherent whole;
- The policy vision remains too abstract, providing insufficient guidance for employees, as a result of which employees have difficulty understanding what the change means for them as individuals or for the work of their department;
- Efficiency is reduced as different parts of the organisation perform the same activities;
- People push themselves too hard;
- They remain in 'survival mode' and changes fail to materialise;
- Organisations take insufficient account of the perception that stakeholders such as consumers, shareholders and politicians have of their processes and products (outside-in approach).

Anchoring change

Financial institutions have difficulties with the long-term approach required to bring about and anchor change.

The greatest challenge is to keep the envisaged effects in mind, anchoring change by means of genuinely different conduct. While the management vision is often translated into objectives, little attention is paid to translating these objectives into specific forms of desirable conduct. Moreover, little attention is paid to what the envisaged change means for the organisation's culture. We found that changes are often initially approached from an instrumental perspective, via systems, processes and procedures. Although the majority of the organisations understand that such an instrumental approach is not enough to achieve lasting changes in conduct, not much work is being done actively on those aspects that are vital to achieving and guaranteeing lasting change.

The problems financial institutions encounter when bringing about and anchoring changes present the following risks:

- Changes are not completely adopted before attention shifts to newly announced changes;
- Staff revert to their old ways as changes are too long in coming, and not enough time is taken to develop new forms of desirable behaviour;
- People continue to behave in the way they did before, as they are not given sufficient coaching in the desired conduct and are not held sufficiently to account;
- They are confused and give up, as the old and new (i.e. desirable) organisations coexist alongside each other and demand different, often contradictory, forms of conduct. For example, in the old organisation it was considered very customer-focused to make exceptions for certain customers, but in the new organisation this may no longer be regarded in the same way, due to high (hidden) costs;
- The change strategy is not sufficiently differentiated when it comes to paying attention to the different paces of the process. As a result, some staff members do not feel sufficiently included in the paces of the process. This leads to them giving up and losing faith in the organisation.

Insufficient time and space for self-reflection

Financial institutions have problems with self-reflection during change processes and therefore do not learn enough from experience.

Although they are very willing to learn, during change processes organisations pay little attention to how matters are proceeding, what works and what does not. There is not enough time for self-reflection. As a consequence, working methods that have been used successfully elsewhere in the organisation are not sufficiently used as a learning tool. People do not get around to self-reflection at a deeper level, such as thinking about whether the adopted leadership style is effective in the current phase of the change processes and whether it is in keeping with the motives of management.

> “This study has been a useful test for us. It also underscores the need to pay attention to ‘reflective learning’. We recognise that this is important, but sometimes we don’t give it the attention it deserves owing to our busy schedules. In future I’d like to free up more time for reflective learning and be more conscious of it.”
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> Dorothee van Vredenburch, Member of the Management Board of NN Group

Organisations that take the time to reflect often focus very much on content rather than emotions and behaviour during the change process. When plans and working methods are adjusted during the course of the change process, this is often done unconsciously and is considered to be a necessary evil (such as deviating from the plan) rather than as an effective intervention. In addition, we found that those at the top of the organisation, middle management and the ‘originators’ do not seek out different or dissenting opinions. Disappointments and actions that need to be abandoned are not discussed either. In fact, our study revealed that the bearers of change want to persuade people who hold different opinions that making the change is the right thing to do. The bearers of change are unaware of this pitfall and often believe that they are in fact organising dissention.

Inadequate reflective learning carries the following risks:

- Opportunities for improvements are not identified or made use of;
- People who voice criticism are not adequately heard and stop being involved;
- There is inefficiency due to the fact that not enough is learned from successes elsewhere in the organisation;
- Leadership style and change interventions are not adequately aligned with the factors needed for the process of change, leading to stagnation or even failure of the change process;
- There is not enough dissention within an organisation (organisation consists of yes-men);
- Too much emphasis is placed on ‘doing’, and little time is taken to reflect on what the organisation wants to ‘be’ (essentially the management vision behind the actions);
- Any temporary lack of certainty or knowledge during a stage of the change process is unacceptable and an indication of undesirable vulnerability. A cut-and-dried answer must be formulated as soon as possible in response to every question or dilemma.

Leadership plays a decisive role

Leadership plays a crucial role when it comes to success factors and impediments.

Although leadership in itself is not the subject of the study by the AFM and DNB, the importance and role of leadership emerges in all studies. We found many strong, knowledgeable and committed managers at the top of organisations. They play a crucial role when it comes to enhancing willingness to change among staff. Top management also plays a key role as a source of inspiration, and can get the organisation moving. There is also a great deal of openness and willingness among management when it comes to discussing the change process and helping find solutions.

During our interviews, we observed a lack of diversity in leadership styles throughout the entire change process. The preferred style is a results-based form of leadership that resembles crisis management. Another common form of leadership we encountered was based on more technical aspects. These are all good qualities to have at the initial stage of a change process. However, we did

> "You need a thousand small changes to achieve one big one. You can compare it to a big, heavy lead ball. If there are just a few of you it is impossible to get it rolling, but it can be done if everyone pushes together."
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> Marco Keim, CEO AEGON Nederland

not come across anywhere near as many leaders with a natural feel for ensuring that change reaches every part of the organisation. Another striking finding is that top management is often closely involved at the start of a change process, but not at all in implementing or anchoring change. It is crucial for top managers to remain involved until the end of the process, and to be alert to signals and make adjustments where necessary. We also saw relatively few effective people managers, motivators who can adequately explain to their staff what the change means.

Management and middle management is currently not always able to link the vision at the top of the organisation to the – sometimes small – successes achieved by people on the shop floor. As a result, opportunities to show the organisation that it is on the right track, which can create positive energy, are missed. Middle managers have to act as the link between the people on the shop floor and those at the top of the organisation. This means that in addition to having to deal with their daily workload, they are also required to translate the vision underlying the changes into specific behaviour to ensure that staff members contribute ideas and genuinely change in order to achieve success. Middle management therefore has an important and difficult job to do when it comes to ensuring successful change. Not only must middle managers be facilitated by top management, but they must also receive recognition for the heavy task they have to deal with.

How will we follow this up with the financial sector?

What will the AFM and DNB do?

We will continue to use the capacity for change methodology in the future as we are convinced that this instrument helps embed desired change in the financial sector. We will discuss the importance of capacity for change with the sector on a long-term basis. In the next years we will conduct further research into capacity for change, and we will determine what action is necessary in dialogue with the management of the banks and insurers. When it comes to solutions, there is not one size that fits all, and so we will make separate decisions for each organisation.

Moreover, to ensure that organisations remain capable of responding to changing circumstances, we will in any event require that they continue to pay attention to anchoring the changes in culture and conduct at the organisation. We expect senior management to be willing to change and be capable of self-reflection, and to invest in skills. Our role is to promote change, and to this end we will in the next few years continue to invest in our own knowledge of the capacity for change within organisations.

What do we expect of banks and insurance companies?

Change is an art in itself, and organisations need to invest in developing management skills in this area. It is crucially important to anchor knowledge of capacity for change at the top of the organisation. Top management should not simply leave the change process to a project group or HR staff.

We expect management to know how to implement change and to be aware of their organisations' strengths and pitfalls.

We also see opportunities for other change managers, such as HR staff, project leaders or compliance managers. They can take on a facilitating role by initiating a dialogue on factors that impede the capacity for change, and by looking for potential ways in which the organisation can improve. Given the complex nature of change management, it should not become a box-ticking exercise. It is not enough to translate impediments into guidelines, procedures and the like. Change managers could ask the following questions. How can we ensure that we take the time and the opportunity to learn from change? What exactly do we want from staff in terms of desired behaviour? How can we ensure that we not only embark energetically on the change process, but also have the right people for implementing and anchoring change? What do people need in order for the change process to succeed?

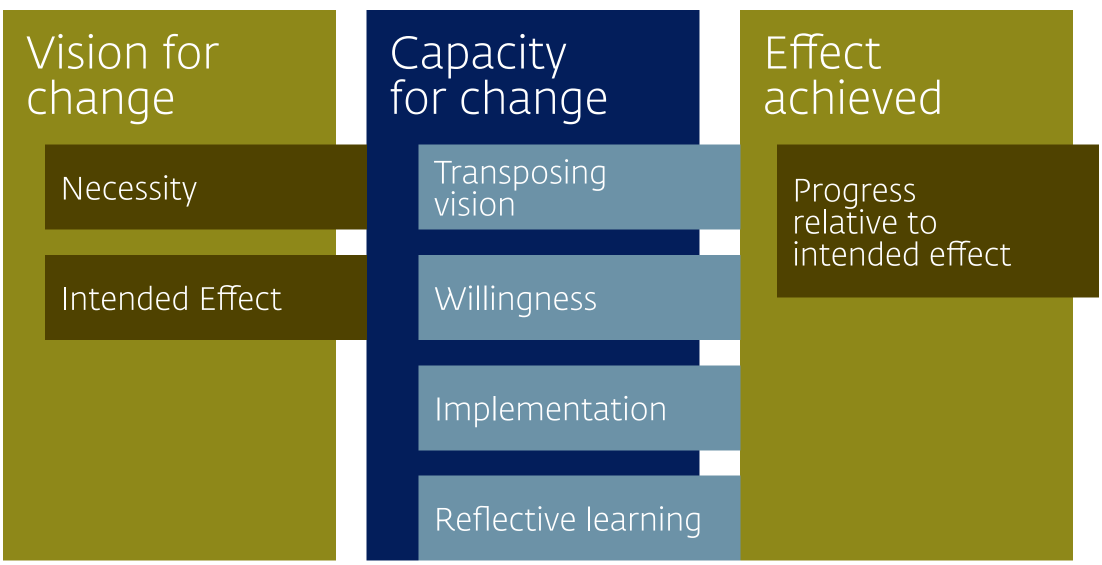
We also noted that most of the organisations we visited are still fully occupied with their own business, putting their house in order, working on their systems and developing the right culture. Their focus is inward-looking. However, in order to achieve their goals and become sustainable, customer-focused organisations, they need to broaden their perspective to include the wider environment and their customers, and bring in external stakeholders. Change managers could make a contribution in this area by facilitating stakeholder feedback.

It will take years to achieve the envisaged cultural change in the financial sector. It is important to explain to customers that we are at the start of a long-term process and change cannot be accomplished overnight. We therefore call on the sector to continue performing its own critical analyses of success factors and impediments and take the appropriate action.

Part 2:
Research methodology

In the study conducted by the AFM and DNB, the capacity for change at an organisation was documented on the basis of four aspects, which are shown in blue in the chart below.

These four aspects are explained in further detail below. First, however, we will give a brief description of the organisation's 'vision for change' and the 'effect achieved'.



Vision for change

In its vision for change, the organisation describes at a strategic level where it wants to go and what its objectives are. This vision may take very different forms, ranging from a rough sketch to a detailed document. Two aspects are considered: the necessity of the change and the intended effect. With regard to necessity, we are interested in how it is expressed specifically (‘why make the change’) and the way in which this was done. With regard to intended effect, we look at how clear and specific the ambition is described (‘what’ and ‘for what purpose’) and how the description was made.

Effect achieved

In our study into capacity for change, we looked at factors that contributed to the original objectives (as described in the vision) being achieved or not, in the organisation’s own opinion. We considered this from different perspectives, such as who decided whether the change process was successful or not. In our interviews with staff, we asked questions such as the following: ‘Are there any individuals or groups who have a different perspective and, if so, what is their perspective?’

Transposing vision

We looked at the way in which the organisation translated its vision in terms of the work ethic and behaviour of employees and the organisation’s culture and structure. In other words, we looked at whether employees are enabled to actually achieve the envisaged change.

In order to manage and communicate about a change process, the organisation must have a detailed rationale that explains to all concerned why the change is relevant to them. The change initiators usually have a rationale of this kind in their minds, but they rarely state it explicitly. This makes it difficult to determine whether the reason given for the change makes sense. The rationale behind ongoing changes can be worked out using simple open questions, such as *Why make the change? What is to be changed? To what purpose? How? Who? When and where?* These questions are also useful when updating the rationale. After all, change is a dynamic process. It demands that the organisation continues to discuss its rationale and keeps it up to date during the change process.

> "We now focus management more on desired behaviour. This forms part of the development of a culture of excellence and the initiatives that support it. We have launched a leadership impact programme and are developing a code of conduct based on business principles for managers. We are also looking actively for what we call 'bright spots' – staff members who make a difference owing to the way they conduct themselves. We focus on them as role models. We are also carrying out a pilot study for the development of a feedback app. We hope that these and other initiatives will enable us to achieve the desired changes."
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> Daniëlle Balen, head of Compliance Conduct, Standards & Expert Advisory, ABN AMRO

Willingness

Willingness says something about people's motivation to ensure that change is successfully achieved. It also relates to the way in which people talk about change and how they feel about the plans and procedures. How people actually experience change is often very different from the situation as set out on paper.

The formal organisation consists of a set of organisation charts, job descriptions, hierarchical lines and procedures. The reality as experienced by the people working within the organisation is often very different, however. The informal organisation is based on social relations and shared perspectives. There are countless informal networks, made up of varying sizes of groups of people who have a specific shared reality. The way in which people operating in these networks discuss change with each other determines the context in which the change initiative or intervention has to be implemented. All the formal actions, interventions, communication bulletins and sessions that are part of a process of change form a whole that can be considered the upper stream of the change.
The question is how these actions and interventions are received and interpreted in the place where the change actually has to be achieved, i.e. the lower stream. In our studies we considered whether these upper and lower streams complement each other.

Implementation

We define implementation as the actions of those involved, the activities and interventions that are used in order to achieve the specific change. This may include temporary projects as part of the change process and changes in people's day-to-day activities. The following questions are relevant in this context. Which aspects of the change initiative have made a lasting impression? How are employees involved in the change process? Who has the initiative?

Reflective learning

It is important to learn from experiences with change. By learning, we mean the ability to identify and rectify mistakes and the ability to discover new perspectives and apply them in change processes. The challenge is to work out what is at the root of undesirable effects or side effects of the change process and not to keep repeating the same knee-jerk response. The deeper the learning, the longer the learning effect lasts. Reflective learning can have implications, for example in the area of implementation (modifications) or for the adjustment of the vision of change.

Research approach and tools

In each part of our research we applied various tools at different moments and used several observers. With regard to 'transposing vision', we examined whether the organisation had a clear narrative as to the who, where, how, what, why and wherefore of the change and when it will take place. We also made use of the *All Quadrants All Levels* system developed by philosopher Ken Wilber. This tool provides a good picture of the different types of the efforts made by an organisation in the context of a process of change. Is it an all-encompassing process, or does the organisation approach the process in a very one-sided way, for example by only tackling processes and systems and leaving behaviour, culture or intentions out of consideration? And is this appropriate for the change brief?

For the “willingness” and “implementation” elements we also used the success rate indicator, a questionnaire that we distributed among staff of the organisation.

The questionnaire pays attention to the necessity, the ambition and the implementation of the change. It also distinguishes between the upper stream and lower stream referred to above. The questions about the upper stream relate to what has been formally arranged and said about the change.
The questions about the lower stream relate to what employees really feel and what they think the changes are about.

Interviews yielded the most information about each element of the capacity for change model. They showed us what really inspired people, what had been achieved, what their concerns were and whether attention was waning.

After studying various issues, we looked for patterns and common themes. In dialogue with the organisations, we sought the correct interpretation of our observations. The organisations have started to put our findings to use and are keeping the supervisory authorities informed. As a result, further discussions of the changes have been started with some organisations, while others have made more practical adjustments that are in keeping with existing initiatives. The experience gained has also been incorporated in training courses, or considered choices have been made in relation to change initiatives.

More information about capacity for change

We carried out our research into capacity for change in the context of our role as supervisors of the financial sector. The project was carried out in close contact with the participating financial institutions. The AFM and DNB used their own research methods. There are of course several practical models and effective methods for studying capacity for change, and many of these contain the same elements as the methodologies that we used. We regularly meet with change experts, such as people working for leading consulting firms that are active in the financial sector, and share knowledge with them in order to keep abreast of recent developments in the area of change management.